

CITY OF GROVE CITY, OHIO COUNCIL MINUTES

December 30, 2010

Special Meeting

The Special Meeting of Council was called to order by President Berry, at approximately 4:00 p.m. in the Council Chambers, City Hall, 4035 Broadway. Roll was called and the following members were present:

Greg Grinch

Maria Klemack

Ted Berry

Steve Bennett

Melissa Albright

The Chair explained that this meeting was to receive an update from the Law Director concerning the IRS issue facing the City. He then recognized Mr. Smith, Director of Law, for a presentation.

1. Mr. Smith explained that he is charged with defending the city. He showed a slideshow and went through a timeline of events from the date the City Administrator received the letter from the IRS (12/9) to today.

He said many of the steps they have taken were done to preserve our rights. He mentioned that putting someone on paid administrative leave is not any indication of guilt or misconduct. It is a way for the City to look into things. He said any misconduct will play out with any investigation. He said they put our insurance company on notice, in case we need to file a claim. They put the Forensic Audit Company on notice, so they would preserve their records. He contacted the Franklin County Prosecutor's office, and at the Prosecutor's recommendation, the City's Police Division began a criminal investigation. Mr. Smith stated that this investigation is interesting due to the Garrity Law. He explained that this Law states that any statements an employee makes, at the threat of losing their job, cannot be used against them later in any type of criminal setting. He said it is very difficult to do an internal investigation and criminal investigation at the same time. So, the criminal investigation is now taking place.

He said he has interviewed Independent Auditors and have selected one. No agreement has been signed yet. He and Mr. Dunn had a meeting with this Audit Firm to discuss the services needed. The Firm said they would like to come in for a week or two and do a review in order to determine the full scope of services.

He said they have a follow-up phone conference set up with the IRS on January 18. He said there is a very narrow window to appeal the penalties and interest portion. Although we are still dealing with the IRS, they are filing that appeal – just to preserve our right.

2. Mr. Smith then introduced Mr. Harvey Dunn, a founding member of their firm and has extensive knowledge, awards and accolades in the tax area. He worked for the IRS for a time and Stephen said Harvey is the best tax lawyer in the State. He is handling the tax side and dealing with the IRS for the City on this issue.

Mr. Dunn provided a very detailed explanation concerning his dealings with this issue so far. He said there are three things we must address with the IRS immediately. These are: Pyramiding, Delinquent Returns, and the Trust Fund. He said pyramiding is allowing a taxpayer who is delinquent in their Withholding Tax to continue to build up the amount of money owed to the IRS. What the IRS doesn't want is people taking current money and paying a past bill. They want current bills paid timely. They want to get their arms around the past due amount by fixing

that number, subject to interest and penalties, and deal with that separately. He said they addressed the pyramiding issue immediately by making a \$189,000.00 payment, which brought the current quarter up-to-date. He said the next item to address is the Trust Fund issue. He explained that the Internal Revenue Code provides that whenever a business is required to withhold and pay over any tax, and you fail to do so, then people in their individual capacities are responsible. These collected monies are Trust Funds. He said there is a very short statute of limitations on the 2007 Trust Fund Recovery penalty, which would cause the IRS to move expeditiously. When the IRS begins a case for this, it becomes very uncomfortable for many people. So, they worked to get this off the IRS's pressure plate. He said, with significant help from Mr. Turner, they have worked to tie down the numbers and verified the amounts from 2007 to the third quarter of 2010. He said payment was made today (\$302,000.00), with an explanation letter, by hand delivery, for the Trust Fund quarters that were in the IRS notice. He said the next issue was the delinquent filing of Tax Returns. He said three of the five were delivered today. Mr. Dunn noted that copies of many of these returns were found in the Finance Office. The other two have been prepared and they have asked Mr. Turner to verify them against actual payroll records. They hope to deliver those next week. He said in the course of preparing these returns, it appears that there was a mistake made in processing by the IRS. There seems to be some confusion between the third quarter of 2008 and the 1st quarter of 2009. He said the IRS processed the returns incorrectly and had the dollars mismatched. This was addressed in the cover letter that was hand delivered today and suggested to the Revenue Officer that it be the subject of a future discussion. He said with this, they have pretty much addressed all the pressure points. He said there will be a period of time for the Returns to be processed. Notices will come out to the city. No action will be taken, because once the notices come out, the Revenue Officer can take jurisdiction of the case and control what happens after that time. He said they also received a commitment from the IRS to not file a tax lien on the city without providing notice first.

In going forward from here, Mr. Dunn stated that they have also asked Mr. Turner to list all payments made to the IRS. There are payments that the IRS doesn't show credited and are not on the transcripts and he suspects they were used to pay for other quarters. He said they have asked for a transcript from the IRS to assist with this evaluation.

He then explained that the IRS has no ability to waive interest, but can waive penalties and they will file an appeal for those penalties. He said that appeal can stay with the revenue officer for 90 days. There is also a statute of limitations on being able to waive penalties. The revenue officer will review this appeal and it may get transformed into a penalty appeal case instead of a collection case - which gives us more time to deal with the IRS.

He said this case will have peaks and valleys. It is at a peak now. It will slow down, but as long the City is timely with its current taxes, the problem won't get worse. He said they think that the City owes an additional \$472,000.00, exclusive of penalties and interest. He said there is another Taxing Authority that will more than likely show up and that is the State of Ohio. They have the same Trust Fund Penalty that he will deal with for the City.

He said he also interviewed the Independent Audit Firm. He is confident in the information Mr. Turner has provided. He said this Firm will verify the returns, find out how this occurred, and assist with reasons to abate the penalties. He said they will also be looking for reasons to help with the penalty portions from the IRS.

Mr. Bennett asked for clarification on the additional monies owed, with all the payments we have already made. Mr. Dunn explained that the \$665,000.00 has been applied to tax periods prior to

2007. He said, most likely, a notice was received, and to avoid a problem with the IRS a person just wrote a check and sent it in. Where that money got applied, we don't know yet. He said the \$472,000.00 represents tax dollars due on the period commencing from 1st quarter of 2007 thru the third quarter, 2010. They are balances still due, but haven't been assessed and sent to a Trust Recovery. He said there is a reason they don't want to anticipate it today. It is quite strange, but when computing the interest due, those numbers can change. He said they are purposely waiting to minimize the issue. When there is a mistake, it takes more work to fix it than wait for the most accurate number you can get. Waiting ends up being more economical. He said getting the IRS to change incorrect postings takes some work and will take some time.

Ms. Albright asked if the \$472,000.00 represents the five quarters that were turned in. Mr. Dunn said yes, exclusive of penalties and interest. Ms. Albright confirmed that the \$302,000.00 made today was exclusive of penalties and interest. Mr. Dunn said yes, it is strictly Trust Fund money. He explained that the IRS took the payments that were already made on those returns and, where the payments were less than the taxes due, applied them to the employee FICA, the employer FICA and then last, the income tax. He said there were a couple of quarters where the payments were more than the taxes due, and it appears that the IRS applied the overage to penalties and interest. He said the payments made today had a note on the check to designate exactly where the monies were to be applied. That way, the IRS cannot apply those monies to anything else.

Mr. Berry stated that Mr. Dunn is basically saying we owe \$1.1 million. He asked how much money is left in the account to pay this amount. Mr. Turner said there is \$100,000.00 left in the account that has been withheld and not distributed to the IRS yet. Mr. Dunn said, if he understands the numbers correctly, \$187,000.00 was used to pay the current quarter to stop the pyramiding and \$100,000.00 is still left in that account.

Mr. Bennett asked why Council isn't being asked to appropriate monies to pay for this. Mr. Turner said they used monies from current appropriations to make the \$302,000.00 payment today. He said we have enough money from current appropriations to pay the additional Trust Fund \$370,000.00. After that, there will need to be an appropriation to cover whatever penalties and interest come our way.

Mr. Bennett asked about proper controls and procedures for the future. Mr. Dunn said he believes that will be part of the review by the Independent Auditor. He said we need internal securities.

Mr. Berry asked what the legal fees would be. Mr. Smith said they would get a budget together and submit it.

Mr. Berry said if Mr. Smith will let Council know, they would like to hear the progress from he and Mr. Dunn on a regular basis. If timing does not fall during a regular meeting of Council, they would hold another special meeting.

The Chair recognized members of the audience that wished to speak.

1. Mr. Dick Rutherford commented that this isn't a life and death matter, but it is serious in cost and respectability. He said the City has a chain of responsibility starting with the Mayor, down to the individual charged with a task. He said the ultimate responsibility is going to be with the Mayor, as he has the responsibility of the people responsible for supervising the work. He said this Administration, and perhaps those prior to, have a responsibility that will need to be discussed at the proper time. Once the facts are known, he expects the people who are responsible would step up and take their responsibility and explain what has been done to rectify it. He said there is an

old saying that: "people who handle the finances of a company need to take their vacations each year". He said that means you want others to see what takes place in that area each year.

2. Mr. Allen Houk recommended that payroll be moved outside the Finance office. He also suggested that they do not wait any longer in hiring a CPA Firm to take a look at things from a two part perspective. He said it seems to him that the problem is two-fold from an accounting procedure: 1) accuracy of the payroll tax returns, which is totally separate and distinct process from forensic accounting; and 2) some sort of misuse of funds, a separate forensic accounting for this.
3. Mr. Bill Ferguson said with his past experience with the Administration, he said he has a problem with independent consultants/studies by Administration. He said he means no disrespect to the Police, but, he has a problem with the administration handling this investigation and suggests a totally separate, independent audit and review of this issue.

The Chair recognized the Administration and Council for closing comments.

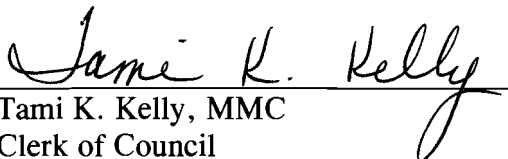
1. Mayor Stage commented that as we have heard, this has been going on for some time. He read an excerpt from the Forensic Audit which states, while they cannot provide absolute assurance, they could find that no wrong doing/diversion/or misappropriation took place by Mr. Behlen or within the Finance Office, during the periods examined. He said there were also three State Audits completed, and none of this was pointed out.
2. Mr. Berry said he doesn't want to delve into anything that will inhibit the investigation and asked the Chief to let him know if his questions do that. Mr. Berry asked who opens the mail. Mr. Honsey explained that a secretary brings the mail up and sorts it into Department mailboxes. Each Department collects their mail and someone opens it and date stamps it, and then passes it on to the appropriate person. This is the system for City Hall. Mr. Berry asked what has changed in this process. Mr. Honsey said they are asking the people who open the mail to take a look at it and any mail out of the ordinary is to be given to the Department Head. Mr. Berry noted that most of the notices were not date stamped, so that tells him they were in the envelope. Mr. Turner said many of them were in the envelope, but he thought the notice was date stamped. It is small. Mr. Berry asked if Mr. Turner is doing anything else to make sure he sees necessary items. Mr. Turner said anything from the IRS is coming directly to him.
3. Mr. Bennett stated that the Forensic Audit previously done was not a full forensic audit. That report did recommend a full audit be performed, but statements were made that there were processes were in place and a full forensic audit was not necessary. He submitted that we may need to consider that in the near future. He also suggested that any forms from a taxing entity be given to the Director of Finance and copied to the City Administrator, so the flow starts from the top.
4. Mr. Smith commented that he is available to answer any questions Council may have. Mr. Berry stated that the Charter authorizes the Council to investigate any administrative office, such as the Department of Finance. He said in his mind, he feels Council should be in charge of the audit and all findings being reported to Council by the auditor. He asked if Mr. Smith had any problem if the audit of the Department coming straight to Council and the scope of work being provided be agreed to by members of Council. Mr. Smith said they have been discussing several services with GBQ. Part of what they would do is providing support to Mr. Dunn and himself. This part of the work falls under attorney/client privilege. He said the audit portion and the internal controls would be public record. As soon as they are in someone's hand, they would be released

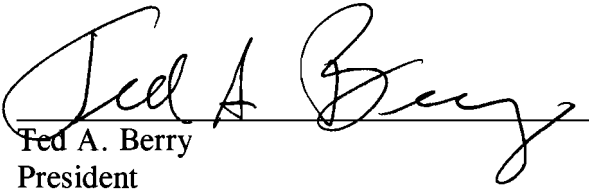
to anyone. He said when Mr. Berry says "come directly to Council" he believes that those materials will come to everyone in the room. He said the independent Audit Firm has indicated that after their initial two-week review, they were going to come back and tell them what they believe they need to look at. He said if Council wants to hold a special meeting and have them come and tell everyone that information, they could do that. He said he doesn't want to say no Mr. Berry's question, because he doesn't think that is the right answer. He believes this can be set up so everyone is involved in the process. Mr. Berry said he wants this to be above reproach. He doesn't want someone coming back saying they audited themselves. He believes the Administrations hands should be removed from any audit. He said it not only protects them as individuals, it allows the city to have that confidence. Mr. Smith said no one advised him on what audit firm to choose and believes they are as independent as independent can be. As they move forward there are issues to be discussed. He said everyone is trying to get is the same place.

5. Mr. Bennett said they not trying to play the blame game. He wants to make sure all areas are reviewed and establish a solution. They want the citizens and all City Officials know that we have a clean slate and know there is nothing else creeping around. He feels it is prudent and incumbent upon the Council to call for a complete examination of all the records to make sure we are where we need to be from now on. Mr. Smith said he understands and agrees. He said he thinks, as Law Director for the City, gathering that information or having it gathered is in their best interest because it is going to assist them in dealing with some of the IRS issues. He said the more information that is developed to understand how we got here, will help in moving forward and fixing this issue. He said he believes everyone is on the same page with that.
6. Mr. Berry asked if the Scope of Services could be discussed and agreed to by Council, whoever is chosen. Mr. Smith said he didn't have a problem with that. He stated after the audit firm has made their two week review, they could come in and make their recommendations to Council. Mr. Berry said that could fall at the next Council Meeting. Mr. Smith said he wasn't sure about the next meeting, but they would do their best. Mr. Berry said, based on this conversation, it is his understanding that the audit firm will appear before Council; Council will be able to ask questions, prior to doing the audit; Council will discuss the scope of work with the audit firm. Mr. Smith said yes. Council nodded in agreement with this process.
7. Ms. Albright commented that there is obviously some trust issues that need to be worked out with the constituents to make sure they know the right thing is being done. She said we need to establish credibility and thanked Mr. Turner for looking ahead of time, before Ohio comes to the City, and trying to fix this issue. She said, as a City, we need to be squeaky clean everywhere. She feels we should use whatever means possible to mitigate the penalties. Going forward, we need to look at policies and procedures so we don't have these problems again.
8. Mr. Bennett said he had a conversation with Chief Wise and believes he is fully capable of forwarding a thorough investigation, with complete autonomy since he is under Civil Service. He said we are doing everything to remedy this, reconcile this issue and reestablish the trust. We will get to the bottom of this and continue to make Grove City the community that everyone loves and wants to stay in.
9. Mr. Grinch said we need to continue to peel this onion and exercise patience. We need to trust the people who are peeling that onion. He said it is easy to have knee jerk reactions and turn this into a political football. He said we need to look at the facts, look at the outcome, improve the controls and go from there.

10. Ms. Klemack-McGraw said she believes we are on the right track. She thanked Mr. Smith for his efforts in dealing with the IRS and retaining a firm that is going to review and audit this matter. She read a statement wherein she said she doesn't believe anyone in the City would allow any illegal or criminal behavior of any kind. She believes that all employees are honest and honorable people. She prays it is a simple flaw within the processing. However, her belief is not enough to protect the city. Something appears to be very wrong and they are acting quickly to preserve this integrity or restore it, in case her belief is misplaced. She said many voters have commented about the need for an independent audit. While she believes the people in the Administration are honest, when a problem occurs, she feels it is necessary that this audit be done under the powers of Council. Otherwise, there will be doubt in the minds of many as to the ultimate validity of this audit. Whatever the cost of this situation, it must be identified and addressed so it cannot happen again. This should not be view as a political maneuver. Our taxpayers must have conclusive proof of the fiscal responsibility of our city. In order to increase the fair, unbiased, neutral and thorough forensic audit, she feels Council has no choice but to exercise their authority (and in this case their duty and obligation) under the Charter. With Council and the Administration working together, they will continue to update the public. They must avoid speculation and act on fact. They must allow the professionals to perform their job, without interference. She said she is confident we will come through this with an improved process for assuring our City's financial integrity and work to serving our community's needs.
11. Mr. Berry said it takes years to build a city's good reputation and only one incident to tear it apart. He said Grove City has a temporary black eye and everyone is working together to move quickly to repair that and move forward. He said we have great things happening in the City. There are new companies moving in and we need to focus on getting this solved and moving forward. He said throughout this process, Council wants to be as transparent as possible. The Administration has said the same thing. Council may or may not need to call special meetings, but if someone wants to be on that list, please see Mrs. Kelly.
12. There being no additional questions or comments, President Berry adjourned the meeting by unanimous consent.

Council adjourned at 5:40 p.m.


Tami K. Kelly, MMC
Clerk of Council


Ted A. Berry
President

IRS TIMELINE OF EVENTS

- December 9, 2010: A Notice of Intent to Levy and Notice of Your Right to a Hearing was hand delivered to City Administrator that indicated Grove City owed the IRS in excess of \$685,000 in federal payroll taxes, penalty and interest due to filing errors over the past three years.
- The Mayor, Finance Director, Law Director and Chief of Police were notified of the issue.
- SZD tax and employment lawyers consulted and engaged.
- December 10, 2010: City Council and the Safety Director/Assistant City Administrator notified of the issue. Safety Director/Asst. City Administrator notified Travelers Casualty and Surety Company.
- Power of Attorney granted by City Administrator and initial contact with the IRS made by SZD.
- Assistant Finance Director placed on paid administrative leave.
- December 13, 2010: Finance Director contacted Audit Manager at State Auditor's Office.
- December 14, 2010: Received correspondence from Travelers Casualty and Surety Company of America acknowledging notice of a possible claim.
- December 16, 2010: Initial meeting with accounting/auditing firm, GBQ Consulting Inc.
- SZD contacted Rea & Associates.
- SZD contacted Franklin County Prosecutor
- December 17, 2010: Criminal investigation initiated.
- December 20, 2010: The City made a payment in the amount of \$189,700.84 for the calendar quarter commencing 10/1/10, through 12/14/10.
- SZD conducts telephone conference with the IRS.
- SZD Follow up conversation with Franklin County Prosecutors Office.
- December 27, 2010: SZD met with accounting/auditing firm; GBQ Consulting Inc. to discuss the scope of their engagement.
- December 30, 2010: The City filed the five outstanding quarterly employment tax returns. (3rd Quarter 2010, 3rd Quarter 2009, 2nd Quarter 2009, 3rd Quarter 2008 and 2nd Quarter, 2007.)
- December 30, 2010: The City made a payment in the amount of \$302,037.54 to satisfy the trust fund portion of the outstanding employment taxes due.
- January 18, 2011: Scheduled follow-up telephone conversation with IRS. File appeal to IRS regarding penalties and interest.